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Inevitable loss

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The Inevitable Loss

PRICES, according to economic lore, are fixed by demand and supply. Under conditions of free competition, an increase in demand for a commodity, without a corresponding increase in supply, causes the price to move upward. On the contrary, any falling off in demand, unless accompanied by a decrease in supply, tends to result in a reduction of the price.

In discussions of cost accounting, the assertion is frequently made that prices are fixed by adding to cost a percentage for profit; an assertion which by itself seems entirely logical. A question as to the accuracy of the statement arises, however, when an effort is made to reconcile it with the economic law previously stated.

The conflict seems to center around the use of the word "fix." To "fix" a price in the sense of regulating or controlling it is one thing. To "fix" a price in so far as setting or announcing it is understood, is an entirely different matter. The economist uses the word in the first sense; the cost accountant in the second.

The producer may set the price on his goods. If he is possessed of any business judgment whatsoever he will be governed by the market conditions and guided by the market price. Hence, it will be seen that the regulation of prices is not in the hands of any individual producer but is regulated by the forces of demand and supply.

It is interesting, therefore, to see what effect the present falling market will have on the individual producer. First, he will be forced to take less for his goods. His margin of profit will be first attacked. As the price falls his margin of profit will be gradually reduced until cost is reached. If the decline continues below that point he will sustain an actual loss instead of a reduction in, or failure to realize at all, an anticipated profit. As the price recedes below the point of cost, the loss increases.

It is of course superfluous to say that no merchant relishes having to sell goods at a loss. On the other hand he is, on a long continued falling market, practically estopped from resorting to the alternative of withdrawing and withholding his goods. If he ceases to sell, his direct or trading loss will stop, but his overhead will develop into an indirect loss which will cause him at least to disorganize if he does not liquidate. Liquidation holds no better hope for him than continuing to sell at a loss as long as the market is falling. He is forced to go on if he is to continue his economic existence.

Tracing back to the cause of his loss it is apparent that the combined cost of his materials, labor, and overhead is more than the price at which the consumer is willing to buy his product. He is burdened with the goods and must take what he can get, hoping to replace his stock with lower priced material, labor, and overhead which he may sell later at a profit.

The purveyors of the materials and labor, and the articles and services which comprise the overhead cost must in turn accept lower prices in order that commodities may be produced on a profitable basis. The laboring man like everyone else must bear his share.

Transition to a lower price level cannot be accomplished until every individual sees the light and is willing to accept his share in the inevitable loss which must result from such change.

Comparative Statements

By J. M. Palen, of the New York Office

A COMPARATIVE statement is one which shows the figures at one date or for one period and the increases and decreases therein as compared with the figures at another date or for another period, which may or may not themselves be shown.

Undoubtedly, many opportunities for valuable service to our clients have been lost through failure to show such comparisons in our reports. In our concern over the verification of figures we sometimes forget that the most important function of all statements is to serve as a guide in the administration of business.

To an executive the comparative balance sheet is invaluable. From it he may read not only the present financial condition, but the general trend of his business. Among other things, it draws attention to (1) relative efficiency of the financial management, as evidenced by changes in current assets as compared with current liabilities; (2) an unwarranted increase in the amount of accounts receivable, which may be due to careless granting of credits, poor collection methods, or to a general credit stringency, the latter being warning to the client to provide against the day when his own liabilities mature; (3) increases or decreases in the amount of merchandise stock on hand, which may indicate whether stock is moving less rapidly or more rapidly than in prior periods.

Equally valuable for administrative purposes, if not more so, is the comparative statement of income and profit and loss. The client is of course interested in changes in his financial condition, but he is even more interested in knowing how those changes came about. If he has increased his profits he wants to know whether he did so by reducing costs, or selling expenses, or administrative expenses, or by an increase in the volume of business done. If he has met with a loss he is even more interested in knowing the reasons therefor. A comment to the effect that the ratio of selling expenses to net sales has increased 10.64 per cent. is not only more interesting but vastly more valuable to him than the knowledge that the aggregate of the balances of the accounts receivable is $4.72 less than the controlling account in the general ledger.

In statements to be used for financial purposes comparisons are even more important, for frequently the banker has no other means of knowing whether the client's position is improving or the reverse.

Two advantages in the use of comparisons accrue directly to the accountant. First, they draw attention to matters which should be investigated. Unusual increases